RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Nov. 27, 1991 **LETTER 1083**

QUOTE: A lot of advisories start out with a quote. Well, I'm going to join the parade, so here's a quote from Richard Russell. "Everything starts and ends with the truth. If the US ever wants to get healthy again, it's got to start by dealing with the truth. The truth is that the US federal deficit is not $268 billion (Washington's figure), it's $424 billion. This $424 billion is the amount that has actually been added to the federal debt over the last 12 months. The reason for the difference in the two figures is that the government doesn't tell the American people about the money it is stealing from the various trust funds. Thus our government, our Presidents and our Congress, are lying to the American people. Furthermore, they are operating on the basis of these lies. No nation can remain prosperous if it operates on lies and subterfuge. These cumulative lies will ultimately lead to a major, crushing bear market."

THE MARKET: Overview: On August 25, 1987, just before the crash, the Dow stood at 2722.42. The Dow is now around 2900. This amounts to a total Dow rise of 6.1% over four years or an average of 1.5% a year. Thus, we have seen a great deal of volume and energy expended with little to show for it. Even adding dividends to the Dow, one would have done better staying in T-bills. This comparison suggests to me that a great deal of informed distribution has taken place during the four years since 1987. It's not a pleasant picture.

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In the last Letter I stressed the importance of the investment-grade stocks as exemplified by the D-J Industrial Average. Friday, November 15, saw the Dow fall 120 points, its fifth biggest point drop on record. I thought it was significant that on that day the Dow closed 10 points below its **200-day moving average.** I consider the 200-day moving average to be very important. The 200-day MA represents the average price that investment interests have paid for the Dow over the last 200 days or roughly eight months.

Again, as I stated in the last Letter, *large investment interests, the kind that buy (and sell) the Dow stocks, set the primary trend of the market.* Let me put it another way. *There is nothing more bullish for the stock market than steady buying of blue-chip stocks by large investment interests. Conversely, there is nothing more bearish for the stock market than the steady selling of blue-chip stocks by large investment interests.*

Consequently, the position of the Dow above or below its 200-day moving average can tell us a good deal about the direction of the primary trend. In a primary bull market the Dow will tend to hold above its 200-day MA. In a primary bear market, the Dow will tend to hold below its 200-day MA.

Question: Did the market break of November 15 mean that the bull market is over and that a bear market has started? At this writing, there's no way of knowing. It's just too early to tell. But here are some items to watch: (1) If a bear market has started, I would expect my Primary Trend Index (PTI) to begin trending steadily down. (2) If a bear market has started, I would expect the Dow to bounce around a bit (after its 120 point crash), but then head below its 200-day moving average. The 200-day MA now stands at 3058. (3) If a bear market has started, I would expect the D-J Averages (in due time) to break below significant previous decline points. The points I am watching are the August 19 low of **2898.03** for the D-J Industrials and the August 19 low of **1147.92** for the Transports.

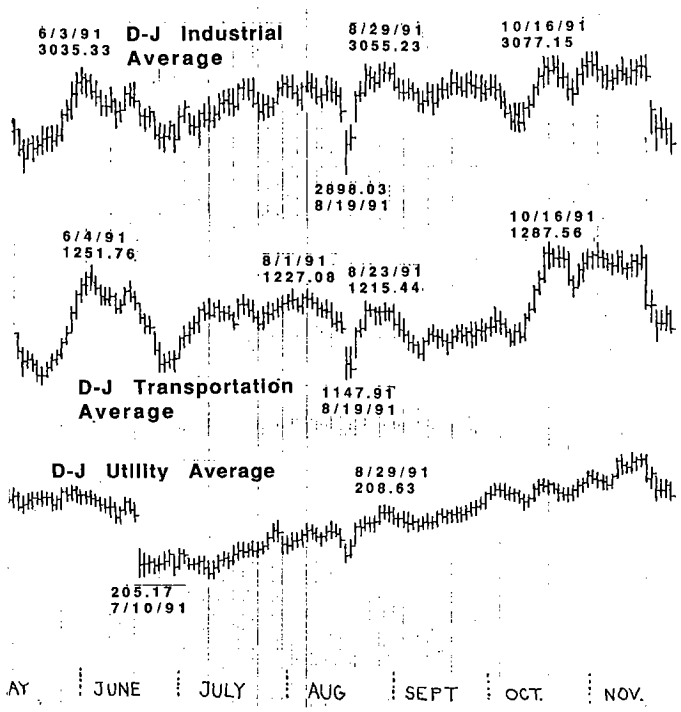
Nov. 15 DJIA 2943.20; PTI 3422; A-D Ratio -10.54
Nov. 22 DJIA 2902.73; PTI 3409; A-D Ratio -11.47
Dow Yield: 3.15%; Dow P/E: 28.8; DowPow: -219
Dow 200-day MA: 2970; Dow 30-day MA: 3025
Dow Times Book Value: 2.18; PTI 89-day MA: 3378
Percentage of Undervalued Blue-chips: 10%

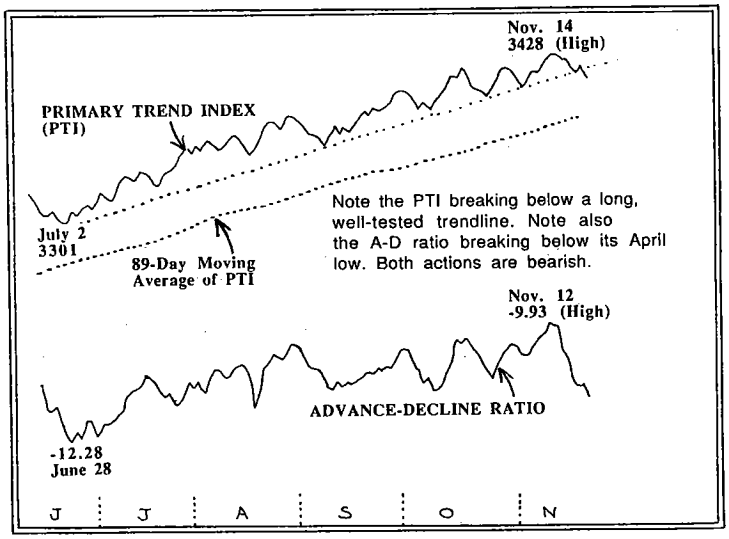
No two bear markets start the same way. Some start with obvious technical warnings. Others don't. Remember this -- the bear wants to take stocks down while keeping the greatest number of stockholders attached to their securities. To do that: (1) the bear must keep hopes alive, and (2) the bear must turn the tide in the most deceptive way possible. If a bear market did indeed start from the October highs, the main hint would have been in the dangerously high valuation in the investment grade stocks. Yes, a market can topple over with little or no technical fanfare. But almost all bear markets begin in areas where equities are wildly overvalued, and certainly equities have been overvalued during recent months.

VALUES: As I stated in the last Letter, a consideration of values constitutes the very heart of Dow Theory. Today, blue chips -- the kind of investment-grade stocks that tend to lead markets and set the primary trend -- are over-priced, and I mean vastly over-priced.

In proof, let's examine the following rundown. To start with, at the November highs the Dow was selling at an astronomical 30 times earnings (I can't remember ever seeing Dow P/E ratios that high). But all right, let's say that this kind of P/E ratio might be allowable if earnings were about to explode. But are they? It doesn't seem like it to me.

The Dow earnings yield was dangerously low at 3.47. The earnings yield is the earnings for the 30 Dow stocks divided by





price. At 3.47, the Dow earnings/yield was actually below the guaranteed yield on Treasury bills!

The Dow's earnings a year ago were 191.52, but Dow earnings have now dropped to 100.77. That represents a dramatic earnings drop of 47.3% over the past year.

Dow dividends were 102.59 a year ago, and they are now 91.31. That represents a drop of 10.9%, a big drop any way you look at it. Historically, it is rare when accumulated Dow dividends decline on a year-to-year basis. A drop of this magnitude hasn't occurred in 30 years.

Here's an absolute shocker (and this is an item that almost nobody has talked about). With Dow earnings of 100.77 and dividends of 91.31, the total Dow dividend payout is an incredible 90.6% of earnings. In other words, dividends now absorb almost all of the Dow's earnings. This tells me that (1) either earnings must boom in the period ahead or (2) we can expect numerous dividend cuts among the 30 Dow Industrial stocks and also among other leading blue-chip stocks.

Finally, dividing the Dow's current value of roughly 2900 by the Dow's book value (1331) we got a ratio of 2.18. Any time the Dow is selling at better than double its book value it's expensive.

So that's the way I analyze the Dow from a valuation standpoint. Conclusion: only a coming boom in earnings would begin to justify the current and recent extreme over-valuation in the Dow.

By the way, last week I spoke to Gerry Weiss, publisher of *Investment Quality Trends* here in La Jolla and Gerry tells me that the Percentage of Undervalued Blue-Chip Stocks is now down to 10%, the lowest it's been in 25 years (it's only been this low once before -- in 1966). Only 38 of the 350 blue-chip stocks that Gerry monitors are now in the undervalued zone, and that's ominous.

Interestingly, in the face of this extreme in over-valuation, the public has taken the bit in its mouth. The public has been buying stocks "like there's no tomorrow." Why? This is the way I analyze it. From one standpoint (and I went over this in the last Letter), the public and Wall Street believe that the Fed, by repeatedly lowering interest rates, will turn the economy around. The general belief is that "it's just a matter of time before the economy heads up again."

From another standpoint, I believe that we have been experiencing one of those unexplainable periods in history when Wall Street and the public felt wildly bullish about the market. Here's the psychology that I think prevails today: "Look at it this way, we had the crash of '87, the mini-crash of '89, the breadth cave-in of '90, and each time the market recovered and went to new highs. Now we've had an 120 drop in the Dow. So what! This market is impregnable; nothing can keep it down for long."

"So why not buy stocks here and just be patient? This market is going higher regardless of whether we have to wait a month for the economic upturn or a year or two years. The next direction for the economy is UP -- therefore, why wait, why not get aboard?"

Consequently, we see headlines like the one below:

Small investors buying stocks in record numbers

ASSOCIATED PRESS

Little Guys Make Big Moves Into Stock Market

NEW YORK — Small investors are returning to the ... wave of trading since the ... of de-

By William Power
Staff Reporter of The Wall Street Journal

NEW YORK—Small investors are trading more actively than any time since the 1987 stock market crash, new statistics show. While the ... aren't quite ... in options trading volume, which can signal an overheated market. "It's a cautious optimism; no one has really gone nuts," says Leslie Quick III, president of Quick & Reilly Group Inc., a big discount brokerage firm, where small-investor ... up 39% this ... is only down slightly from the ... and prices near a record, the value of trading is surprisingly down almost 20% ... the securities association says. Investors are "trading lower-priced ... whatever reason ...

Note: Each time the tide turns, the sequence of signals is different. Sometimes my PTI provides an early signal, sometimes (but rarely) the Dow Theory gives an early signal, sometimes a price/breadth divergence provides an early signal, and almost always there are hints in the over- or under- valuation of stocks.

One of the studies I've followed for decades is *Lowry's Buying Power and Selling Pressure* (115 SE 25th Rd., Miami, FL 33129). This service runs two lines, a Buying Power line based on price and volume on the NYSE, and a Selling Pressure line based on the same. On November 19, after nine months of being bullish, the two indices crossed over as Selling Pressure moved above Buying Power. This constituted a major "sell signal." I think this sell signal will prove to be a good one, and my bet is that within a few weeks or so most of my studies will confirm the *Lowry's* sell signal of November 19. In the meantime, be forewarned.

INVESTMENT POSITION: The shaking bull remains in the box. That's based strictly on the fact that the Averages have not yet broken crucial support levels, nor has my PTI yet fallen below its 89-day moving average. Nevertheless, I've been warning that on a value basis this market is on thin ice, and that I personally have been largely OUT of the stock market. I don't like the looks of it.

Our bull is growing smaller, and he's shakier than ever.

Question: What do wealthy investors do when they perceive that stocks are overvalued? Answer: They unload. Then they exercise great patience -- and wait for values to return. I wrote about this some years ago in a piece entitled "Rich man, poor man." In that piece I wrote that the "rich man" doesn't need the markets; he has the wherewithal to "wait it out." On the other hand, the "poor man" (read middle class) needs money badly, and the poor man will enter into all sorts of questionable investments in an effort to "beat the market," investments that will turn into guaranteed losses when the next bear market gets underway (I guess I should repeat that "Rich man, poor man" piece in the next Letter or so).

I know the newspapers and magazines have been bulging with ads telling you "how to make money." My perception and instinct is a bit different; I feel that this is the ideal time not to lose money. You do that by getting liquid.

My old friend, Joe Granville, has seen fit to attack a few advisors including me. In his current report Joe notes that I was quoted in

USA Today as advising subscribers to sell everything and to get liquid. Then Joe complains, "The latest issue of Russell's letter shows a bull in the box. He refers to his bullishly performing Primary Trend Index. So he has it both ways. If the stock market collapses he can proudly advertise the fact that he had all his subscribers prepared for the worst. On the other hand, if the market keeps going up he can advertise the fact that his PTI said the market would go higher. He can't lose. He has a perfect straddle. But it is misleading."

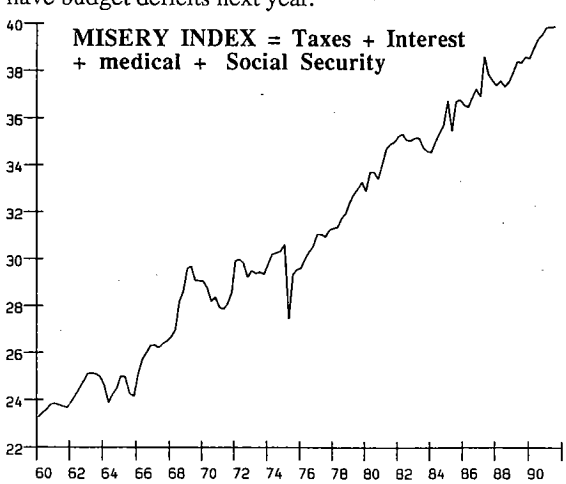
Well Joe, first I never like to fight with other advisors. I think advisors should use their energy to fight the market. Secondly, I don't "advertise" my results. But Joe's complaints and criticisms are interesting. Joe likes to think in terms of black or white. Joe thinks you have to be a total bull or a total bear -- no nuances, no ifs, ands or buts. I don't agree. People who are always cocksure in this business usually end up as the butt of some newspaper columnist's unkind joke.

I tell my subscribers what my PTI is doing, I also tell them what I think, and lastly I tell them what I personally am doing. My PTI cannot reverse on a dime. It takes time for it to turn up or down and then break above or below its moving average. Furthermore, the market is often in limbo, and at such times neither I nor anyone else can determine with certainty whether it's bullish or bearish. However, I do know whether stocks are cheap or expensive, and I've been saying for some time that regardless of my PTI or anything else, stocks are expensive. They're still expensive and in Letter after Letter I've been warning my subscribers about that.

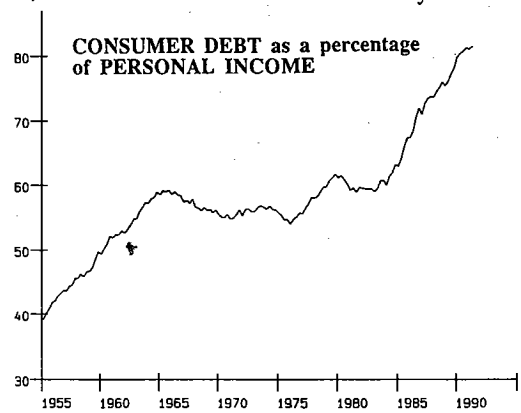
It doesn't bother me a bit to exit a rising and overvalued bull market. And that's what I've done. Joe, you're still bullish, and that's fine with me. Another thing. There's nothing in Dow Theory that tells us to stay invested in an overpriced bull market, waiting until a bona fide bear signal is given. The idea is to get out before the bear signal. At the same time, the Dow Theory advises buying (again, based on values) prior to a Dow Theory bull signal. That's exactly what we did, for instance, at the great 1974 bottom.

So Joe, my suggestion is don't fight me -- better to fight the market. Besides, if you beat the market you'll make a lot of money. But you won't make a nickel beating up on me or anyone else.

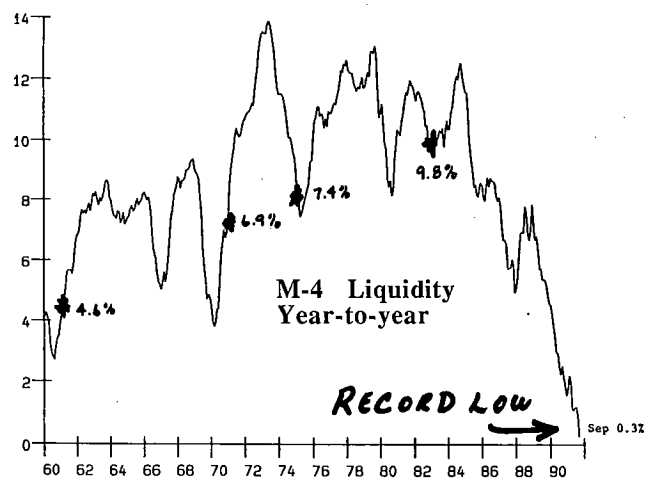
CHARTS: Do you wonder why consumers are hurting and pulling in their horns? Study this chart of Ed Hyman's "Misery Index" (courtesy of *International Strategy and Investment Group*). Ed notes that "in 1960 24% of personal income was used to pay -- taxes + interest + medical + Social Security. In 1991 40% is being used to pay those mandatory items. So even if Federal taxes are cut in 1992, consumer spending could remain sluggish due to higher state & local taxes, medical payments and Social Security payments." Russell comment: The items listed above are leaving middle class Americans "hanging on the ropes." And ironically, despite tax boosts by 34 states in 1991, it looks as though 30 states will have budget deficits next year.



The next two charts are crucial for understanding what's happening in today's economy. This chart shows consumer debt as a percentage of personal income. The current figure is a staggering 81.7%, In other words, consumers have taken on debt to the point where that debt now equals four-fifths of their income. Talk about a squeeze, no wonder the consumer is "in misery."



This is a scary chart. It shows the growth of **M-4,** which is sometimes called Liquidity, and it's the broadest measure of the money supply. Hyman notes that the September decline in M-4 marks the first time in history that M-4 declined four out of six months. The black dots on the chart denote the spots where previous recessions turned up. Hyman states, "At the beginning of previous recoveries, M-4 growth has been 7%." He also notes that "M-4 growth tends to lead Total Debt by 2 years." Russell comment: Gad, if that's true, then the still-declining growth in M-4 is telling us that the current debt run-down will last at least through late-1994. If people and corporations continue to pare down debt for the next two years, then we're facing one very sick economy (Donald Trump says we're "in a depression." We're certainly in a commercial real estate depression, and M-4 could be telling us that it's going to be broader than just commercial real estate).



Russell comment: In less than 90 days George Bush will be facing voters in the New Hampshire primary. New Hampshire's economy is now among the worst in the nation. The Democrats are claiming that the NH primary will be the unmaking of the Bush Presidency.

NOTES & QUOTES: For those who invest using the formula of simply buying the top yielding Dow stocks each year, here are the top Dow yielders: (1) Westinghouse 7.78%; (2) Sears 5.32%; (3) Union Carbide 4.91%; (4) Texaco 4.89%; (5) Amer. Express 4.71%; (6) IBM 4.64%; (7) Eastman Kodak 4.48%; (8) Exxon 4.40%; (9) Chevron 4.26%; (10) Gen. Motors 4.24%. Russell comment: I look for many dividend cuts during the remainder of '91 and in '92. So the figures above will be subject to many changes. After staggering losses last year, GM will probably lose around $2.7 billion in '91. This will mark the first time in 60 years that GM has suffered back-to-back annual losses. Some people are talking about total omission of the GM dividend.

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Wallace Peterson, University of Nebraska economics professor, labels this the "Silent Depression." He notes that from 1947 to 1973 average weekly earnings for Americans rose. Those were the sweet years of the "American Century." Then something happened. Average weekly earnings began to fall. In constant dollars, the average worker earned $327.45 in 1973. By the recession year 1982 the figure had slipped to $276.95, and it didn't improve with the recovery. By 1990 the figure had dropped to $264.76. What masked the drop in earnings? Answer -- the working woman, the two wage-earner family. Russell opinion: To me the whole picture is one of declining living standards. And something else happened. Kids grew up without mothers, fathers cut out, children inhabited the streets, crime became as American as apple pie, one out of every 10 Americans drew some kind of welfare. And suddenly, it's 1991, and here we are, running the biggest deficits in the history of mankind -- and all the while living standards continue to fall.

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My old friend Doug Casey makes this observation. This year's addition to the federal debt is $400 billion (Russell comment: actually it's more). The total value of ALL US stocks on all exchanges is roughly $3 trillion. So based on the way the debt is building, in the next seven years Washington will borrow a total amount equal to the entire industrial capital base of the nation, a base that it took 200 years to accumulate.

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With the advent of a deepening recession the Bush presidency appears to be self-destructing. Bush is seen as an absentee president who doesn't know what's happening domestically, doesn't know which way to turn, and is dependent on Gray, Sununu and Brady to tell him what do. Furthermore, Bush is seen as a befuddled president who has no personal beliefs or agendas, and is willing to negotiate on anything. This montage from last week's newspapers says it all.

Disarray at the White House has become curiouser and curiouser

By MAUREEN DOWD
New York Times News Service

WASHINGTON — Haunted by the image of Ronald Reagan, George Bush vowed from the beginning of his presidency that he would never be manipulated, isolated or surprised by his staff.

However, in the past few weeks, the President has appeared to Re-

Analysis

dismay among Republicans that's almost like a physical pain," said Eddie Mahe, a Republican consultant with strong ties to the White House.

"It's almost schizophrenic, the way the President keeps lunging in different directions. They have to

In an intensely embarrassing moment that Sen. John C. Danforth, R-Mo., likened to a horror movie, the White House yesterday insisted that the President did not know that his legal counsel, C. Boyden Gray, had proposed reversing long-standing civil rights policies without consulting with Mr. Bush or the Cabinet members in charge of those policies.

Without Beliefs, Bush Stumbles Into Carterism

The Bush administration's amazing descent into doodoo gained speed when the White House executed its latest political somersault off the high bar, this time (again) on civil rights. How many more belly flops can this president stand?

President Bush signed the Civil Rights

White House Isolation

An Image of Bush as a Captive of Top Aides Who Make Their Own Sweeping Decisions

By MAUREEN DOWD
Special to The New York Times

WASHINGTON, Nov. 21 — Haunted by the image of Ronald Reagan, George Bush vowed from the beginning of his Presidency that he would never be manipulated, isolated or

opens his mouth."

In an intensely embarrassing moment that Senator John C. Danforth, the Missouri Republi-

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Interesting Statistics: Last year's military budget was $288.3 billion. This year's military budget is $291 billion. So much for the "peace dividend" . . . One out of every seven children in the US is now on welfare . . . Biotech speculation? Immune Response sold for 2 7/8 in January. At the high a few weeks ago it sold for 61 3/4 . . . Synergen sold for 3 5/8 last year, it sold two weeks ago for $68 . . . GM hit a new 52-week low of 31 1/8 on Nov. 22. A new GM low has never been a good omen for the market. The 52-week low for IBM was 92. Keep your eye on that one.

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From *Forbes* magazine (Nov. 25): "Both California and New York now have top marginal tax rates in excess of welfare-state Britain, which charges a maximum of only 40% on individual incomes above $35,000." Russell comment: It's happening just the way I said it would. First they take away all our tax shelters but they keep us quiet by lowering our taxes. Then a few years later they raise the taxes.

California is showing (despite tax hikes and budget cuts) a further deficit of $3 billion. Studies show that by 1999 there will be more tax receivers than tax payers in the Golden State. NY and CA are becoming the ultimate welfare states. If you want to enjoy the fruits of your labor, the Russell advice is -- stay out of NY and CA.

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This from the latest issue of Steve Breise's *Bullish Review,* a very sophisticated commodity service [(612) 423-4949]: "World stocks of foods and feed grains which were burgeoning prior to 1988 are now at critically low levels as, for the first time in memory, the US government failed to rebuild stocks following that drought year. . . My overall market view is that likely trading opportunities over the coming months will surpass those seen in a decade or more. Specifically, I am looking for a major top in T-bonds (which the US government is in no position to control); resumption of the long-term downtrend in the US dollar (particularly against the yen); major bull markets in grains, oilseeds and softs; an end to the bear market in precious metals and eventual bull markets; and downtrends in industrial metals and petroleum. Obviously, if this scenario plays out, the picture for stocks is not pretty."

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Here's the word from economic Fed-folk hero Paul Volcker. He's telling people that coming out of this recession will be a slow process. "There's no instant panacea. I don't see any series of actions that can healthily create the turnaround politicians would like." And on efforts to reignite the building boom, Volcker says, "We have enough buildings." (Quotes thanks to Dan Dorfman.)

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The other night I saw the Barbara Walters special with Richard Gere, Bette Midler and I forget who the third guest was. Way back when, I used to date Barbara Walters' roommate at Sarah Lawrence College. I got Barbara a date with my buddy, Hal Liberman, and we had a couple of non-eventful double dates. Barbara was moody and I thought unhappy in those days, but that was long ago, and she seems a lot happier now. As I remember, Barbara started her career as an usher at the CBS theater in NYC. She's done pretty well since then.

Hal Liberman's father was President of Arnold Constable, a big department store in NYC during the '40s and '50s. One day I walked into another New York department store, B. Altman's, and I was surprised to see Hal working behind the counter in the men's shirt department. so I asked, "Hey Hal, what are you doing here?" He pulled me aside, "Don't say a thing," he whispered, "They don't know who I am, and I'm using another name -- my father wants me here so I can learn the business from the bottom up from a competitor."

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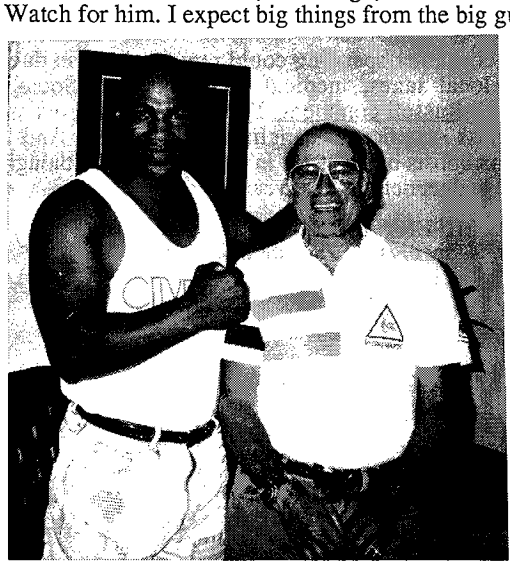
Don't worry, I'm not going to hurt him. This is my friend, Levi Billups. Levi is San Diego's candidate for the heavyweight boxing division (he weighs 230, and it's all muscle). A few weeks ago at the Forum in LA, Levi shocked the boxing world by winning an unanimous decision over contending heavyweight "Bone-crusher" Smith. Levi's a God-fearin' man, he's tough, and he's a student of boxing. Watch for him. I expect big things from the big guy in '92.



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Hollywood: This from page one of the Nov. 4 *Daily Variety:* "Hollywood is in a bad mood. The psychological toll of a

prolonged dry spell at the box office, disruptive management changes at most of the major studios and overall economic slump have cast a pall over the movie business. As the industry struggles to get a fix on the '90s and find its equilibrium, morale has never seemed lower; tensions, pressures, confusion, paranoia and instability never higher. 'We're living on fear and anxiety,' declares an insider at Paramount Pictures, who says the ground at the Melrose Avenue lot hasn't stopped shaking for months. While historically people have clawed and scratched to get into Tinseltown, there are growing numbers looking to bail out. 'I'm hearing more people say, I'm going to get out; I'd rather sell thumbtacks than stay in the business,' attests one senior studio executive. 'The pressures are unbelievable.' "

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A subscriber sent me a copy of H. Ross Perot's speech before the Coalition for Better Government on Nov. 2. If this amazing man would run for president (either party), I'd work for him. He's terrific, he's honest, he's powerful, and he knows what would bring this country back to health. Sample from the speech: "Let's take away the right of Congress to raise taxes because they've acted irresponsibly. If they want to raise taxes, put it on the ballot, and if you think it's worthwhile we'll do it. Let's cut out the deficit spending -- just right now cut it. Expenditures cannot exceed revenues. When you start down this path don't blink. You going to have to eliminate the tricks, the loopholes, the improper accounting procedures. Give the president a line-item veto on the budget. Three reasons. One, I'd like him to quit whining about not having one. Two, I'd like to see what he does with it. Three, if we get real lucky, he'll cut out a lot of pork-barrel." Russell comment: I know some of my subscribers must know Ross Perot. Please, do your country a favor, urge this remarkable man to run in '92. I think the American public has had it with lies and malarkey, I think Americans are ready for action and for the truth. Perot would deliver both.

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Recently, Ezra F. Voget, Harvard's expert on Japan was interviewed. Question: Concerning the new book you are writing on Japan's changing role in the world, what do you project for that role? Answer: If you're talking about the next five or 10 years, and leadership in an emergency like the Persian Gulf War, I think you have to look to the US as the one to lead. But if it's a question of who you look to for economic power, technology, setting the tone for international industrial competitiveness, investment or a model of any kind of development, I think it's already turning more to Japan than the US. I see the college presidents that I know more often in Tokyo than in the US, and I think we have to assume that they are looking for funding. When governors travel, a big bunch of them head for Tokyo, because that's where they look for investment. Countries of Asia and increasingly Latin America, turn to Tokyo rather than Washington. A major global reorientation is taking place."

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The French are invading New York. First it was Galaries Lafayette taking over from the defunct Bonwit Teller, and now it is the famed Le Store moving into the Trump building. Le Store is really a 40,000 square foot boutique with an emphasis on the secondary designs of famous French designers such as Jean-Paul Gaultier and Yves Saint Laurent. Will the new French invasion work? My guess, probably, but they picked a tough time to try it out.

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George Burns, the idol of the geriatric set, may have the right idea. At age 95 George has just signed a five-year contract with the Riviera Hotel and Casino. The contract runs through 1996. Burns says that he intends to celebrate his 100th birthday at the Palladium in London in 1996. In a recent poll, 61% of Americans said they'd like to live to be 100, but only 6% thought they'd make it.

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By the way, if you live in S. California listen to radio station KNX at 9PM and 2AM for re-broadcasts of the great old radio serials such as The Shadow, X Minus One, Dragnet, Gang Busters, The Lone Ranger, The Cisco Kid, Lights Out, Your FBI, Jack Benny, George Burns and Gracie Allen. OK, call me sick, but I love 'em (I usually wake up and catch the 2AM shows).

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A couple walks down the aisle in a movie theater. The man trips on the carpet and breaks his leg. His wife jumps on a chair and shouts, "Is there a lawyer in the house?" Don't laugh, there were probably a couple of dozen lawyers in the house. Statistics: Including my wife, Faye, there are now 777,000 lawyers in the US, or one lawyer for every 320 people in the US. Furthermore, 1991 saw a record 94,200 people apply to US law schools, a 6.6% increase over last year. Over the last ten years civil law suits in the US were up 53%. American has become a nation of people suing each other for "wrongs" or suing others to obtain their "rights."

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Charles Biderman writes *Market Trim Tabs*, and he's very bearish on California. A former writer for *Barron's*, he denies any personal ill will towards the Golden State. He simply thinks the state's economy is heading for a crash. He thinks there's too much debt here, too few new jobs, and way too much hot air under real estate prices. Biderman states that he has seen boom-and-bust cycles before while most Californians haven't. "I think we're entering the greasy part of the chute in California. There are an awful lot of people hanging on by their fingernails," he says. Biderman adds, couple a real estate bear market now with the flight of jobs from the state, and add in the '80s debt load, and the crash has only begun.

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The deflation in commercial real estate has reached massive proportions. The best estimate I can find on the deflation in commercial real estate is an average drop of around 35% from the highs. Here's a true story I just heard from an absolutely reliable source. An New England investor was trying to buy a commercial building from the RTC. The building originally cost $6 million to build. The RTC had it for sale for $1.7 million. The investor got together some partners and put in his bid. Before they could get the building, a large Texas group bought the building as part of a huge package. The price the Texas people paid for the building was approximately $750,000. That price was less than one-third of what the building cost to construct.

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The Japanese have refused to invest in the US Superconducting Supercollider. If it's finished by the year 2000 it will be the world's largest scientific instrument (it will cost $8.5 billion). The Japanese excel in the incremental innovation and manufacturing of technology, but when it come to ideas and original concepts the US accuses the Japanese of "freeloading" on the ideas of the West. Says one leading Japanese scientist, "Politicians in Japan say that they can't win votes by supporting basic research." But Suzanne Berger, head of the M.I.T political science department says, "The Japanese have to come up with something on research. They can't continue to borrow from abroad." She adds that American leaders are increasingly worried about sliding US technological superiority and that US universities are under increasing pressure to restrict foreign access to university research. Japanese corporations have funded 26 chairs at MIT, more than at the University of Tokyo.

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Speaking of Japan, the *Browning Letter* (PO Box 494, Burlington, VT 05402) published a major peace entitled "Japan in a Changing World." I thought this paragraph was significant: "While Japan will continue to readily adopt ideas and technology, these will basically only be ideas which promote the welfare of those in positions of power. And while Japan will continue to borrow and steal ideas, they will, if the future resembles the past, evolve a contemptuous attitude towards those they borrow ideas from. After centuries of borrowing from the Chinese, the Japanese came to view them as decadent and treacherous. After almost 100 years of borrowing from Europe, Tojo's regime dismissed whites as racially and mentally inferior. We can expect a similar attitude to develop towards Americans."

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More Japan: According to the *International Herald Tribune*, Japanese banks will be carrying $153 billion in bad loans to real estate companies by next March. Consequently, the Finance Ministry is not letting Japanese banks extend any more loans to real estate developers. The land speculators in Japan have been hurt, and hurt badly. So far in 1991 alone, 7,338 businesses in Japan have gone broke, leaving behind unpaid debts of five trillion yen or around $38 billion. In Japan, a recession is considered growth of 3% of less. Many people think it's going to be less.

* *

What's really constricting bank lending is the massive shrinkage in the value of loan collateral and again I'm speaking of the deflation of real estate values. The Nov. 12 issue of *Financial World* was almost entirely devoted to real estate. The articles were eye-openers. I include the opening paragraphs in two of those articles here.

THE LIQUIDITY CRISIS FACING commercial real estate today is already worse than the real estate crisis of the Seventies in terms of delinquency rates and vacancies. And the worst is yet to come. If not handled properly by the federal government, this liquidity problem could plunge the economy into depression and delay for perhaps two full decades the recovery of an industry that accounts for 25% of domestic gross national product.

It's no mystery how we got ourselves in this fix. In the early 1980s when thrifts were permitted to invest their assets in something other than home mortgages, money flooded into more lucrative commercial mortgages. At the same time, commercial banks got heavily into real estate lending in an effort to make up for lost corporate lending and commercial paper business. From 1982 to 1990. commercial bank real estate assets jumped from 14% of total bank assets to an alarming 35%.

With an unprecedented amount of money to play with, developers ran amok. The amount of standing commercial property doubled over the decade, causing a glut of office space that will last another 10 years.

Too late, bank regulators slammed on the brakes, says Comptroller of the Currency Robert Clarke. And when they did, it only aggravated the curtailment of bank lending. "Fear of regulatory criticism for adding to, or not reducing, concentration levels has led some banks to hesitate to extend credit to new creditworthy borrowers or to renew existing sound loans," says Clarke.

Today, money is so hard to come by for developers, says Anthony Niosi, Citicorp's vice president of real estate investment management, that "even good buildings can't get built"

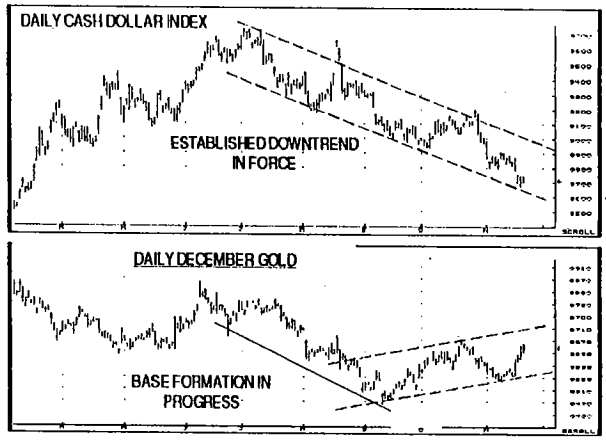
THE REAL ESTATE BUSINESS IN the U.S. accounts for close to a quarter of the gross national product. Even more important, real estate holdings represent roughly two thirds of the nation's wealth. So when property values collapse, as they have recently, they drag our financial institutions down with them and can cause serious damage to the entire U.S. economy for years. And the worst is yet to come (see page 42). Most of the big real estate loans made by the banks will be coming due over the next three years, and the regulators are pressuring the banks not to refinance them, but rather to take the hit immediately. With commercial real estate values as depressed as they are at the moment, this threatens to trigger a major wave of bankruptcies in the banking sector.

In times past, such real estate crises occurred in isolation behind various national boundaries. But as the world's economies have become ever more closely interconnected, this is no longer the case. Today, the real estate crisis is as real in Japan, the U.K. and Sweden as it is in the U.S. About the only significant exception to the rule is Germany, where huge pent-up demand in what used to be East Germany is being satisfied by a major infusion of capital from the rest of Germany for reasons that are as much political as they are economic.

Real estate men, who understand well the linkage to financial institutions, are keenly aware of the gravity of the problem in the U.S. Thomas Lardner, president of Dallas's well-respected real estate investment managers Lehndorff Group USA, describes the collapse as "the most serious problem this country has faced in over 20 years."

GOLD, CURRENCIES: These charts from my friends at *M.J. Capital* (111 Great Neck Rd., Great Neck, NY 11021) say a lot, maybe say it all. The collapse in the dollar (down 10% against the mark since August) has been breathtaking, but the dollar is also becoming very oversold. But as veteran subscribers know, if the dollar is in a true bear market, it can REMAIN oversold for quite a while.

Furthermore, on a purchasing power parity basis, the dollar is cheap. Merrill Lynch estimates the mark is 9.7% overvalued against the dollar, the yen is 19% overvalued, and the pound is 20.5% overvalued. Let me put it this way, Germans and Japanese are going to have a heck of a lot more fun vacationing in the US than you are going to have if you're nutty enough to take your vacation in Berlin or Tokyo.



The lower chart shows gold selling off into a September low (348.20), but since then the picture has changed. On October 22 gold rallied to 366, then sold off again to a November 7 low of 354.70. From there gold has headed persistently higher -- and last week gold rallied above the October high of 366. A head-and-shoulders bottom has formed, and the evolving structure looks powerful. The next objective for gold is the June 10 peak of 376 (spot). Bettering 376, gold should be heading for the 380-400 zone.

Politics is now coming into full play. With the recession gathering steam, the administration has reached the panic stage. Bush's popularity rating has plunged along with the Consumer Confidence Index. The pressure is increasingly on the President and Congress to act. The action will center on lower taxes and spending -- although both will probably be put off until January.

The markets are hardly oblivious to the picture, and they sense a move towards inflation and budget-busting (if you can call what we've got a budget). The dollar has dropped precipitously. The stock market has tumbled. Bonds are in the process of topping out. And gold has headed up. Why is gold strong? (1) It is the only international money. (2) Gold is the only money that is not managed in that it is the only money that is not some country's liability. (3) The safety of gold is a bulwark against increasing trouble in the international banking system. (4) Gold is a protection against the administration's desire to reinflate.

LATE NOTES: On November 20 my **PTI** broke below an eight-month trendline (see page 2 chart). This is a very important trendline connecting the March, June, Sept. and Oct. lows. The trendline break is a bearish indication, and suggests that a full bear signal (i.e., breaking below the 89-day moving average) may not be far off.

The Dow plunged below its **200-day moving average** on November 15, bounced above it for a single day and has been holding bearishly below the MA ever since (the 200-day MA now stands at 2969). A further very bearish signal would be the 30-day moving average (now at 3025) breaking below the 200-day MA. On Nov. 21 the 30-day MA of the Dow turned down (another bearish indication).

I believe the odds are increasing for a world recession or worse. The problems in Japan continue to be severe, and I'm talking about the huge speculative edifice of Japanese real estate, the surging bankruptcies, the problems of the Japanese banks, plus the fact that the Tokyo market never regained even half of its initial 1990 crash losses. Let's keep our fingers crossed. And let's stay liquid and avoid losses.

Finally, watch the August 19 lows on the Averages, **2898.03** for Industrials, **1147.92** for Transports. Break both (and I said BOTH) of those, and I would say that the primary trend of the market had turned down.

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